DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 98-0576
State Gross Retail Tax
For Tax Years 1995 through 1997

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ISSUES

I. State Gross Retail Tax—Exemption Certificates

This issue has been resolved, subject to verification by the Audit Division.

II. State Gross Retail Tax—Unitary Transactions

Authority: *Cowden & Sons Trucking, Inc. v. Indiana Dept. of State Revenue*, 575 N.E.2d 718 (Ind.Tax Ct. 1991); *Monarch Beverage v. Indiana Dept. of State Revenue*, 589 N.E.2d 1209, 1212 (Ind.Tax Ct. 1992)
IC 6-2.5-1-1; IC 6-2.5-1-2; IC 6-2.5-2-1; IC 6-2.5-4-1; IC 26-1-2-401(2)

Taxpayer protests the assessment on delivery charges arguing that such delivery service does not qualify as part of a unitary retail transaction.

III. State Gross Retail Tax—Manufacturing Exemption

Authority: IC 6-8.1-5-1
45 IAC 2.2-5-9(g)

Taxpayer protests assessments of Indiana sales tax on its use of a front-end loader, maintaining that this item qualifies for the manufacturing exemption.

IV. Tax Administration—Abatement of Penalty

Authority: IC 6-8.1-10-2.1(d)
45 IAC 15-11-2; 45 IAC 15-11-2(b); 45 IAC 15-11-2(c)

Taxpayer protests imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation which operates a stone quarry and sells sand and stone from its inventory. As part of its business, taxpayer uses its trucks to deliver sand and stone sold to its customers. The sales tax assessed against transactions for which taxpayer failed to collect sales tax and was unable to provide exemption certificates has been resolved. Taxpayer now protests the Audit Division's proposed assessments of sales tax on taxpayer's retail unitary transactions, as well as assessments of use tax on taxpayer's use of front-end loaders. Additional facts are discussed below.

I. State Gross Retail Tax—Exemption Certificates

DISCUSSION

During taxpayer's audit, the auditor disallowed several sales, that taxpayer maintains are tax-exempt sales, because taxpayer failed to provided tax exemption certificates. Subsequent to the audit, the taxpayer produced exemption certificates applicable to the transactions upon which the auditor assessed sales tax. Because valid exemption certificates existed for these transactions, taxpayer is not liable for sales tax on such transactions.

FINDING

Taxpayer's protest is sustained, subject to verification by the Audit Division.

II. State Gross Retail Tax—Unitary Transactions

DISCUSSION

As part of its quarry business, taxpayer uses its trucks to deliver the sand and stone it sells to its customers, and to deliver sand and stone sold to its customers by other vendors. Because the delivery drivers are not able to calculate the sales tax due on a particular order, taxpayer computes sales tax at taxpayer's office and includes said tax in the price quoted to the customer. Taxpayer then generates a billing ticket for its records that includes the sales tax calculated on the cost of the materials, but does not separate the delivery charge from the cost of the sand and stone. The actual invoice taxpayer sends to its customers, however, does separate the delivery charge from the charges for the cost of

the sand or stone and the sales tax thereon. Upon customer's payment of an invoice, taxpayer remits sales tax to the Department on the cost of the sand and/or stone sold.

At the conclusion of the audit, the auditor assessed sales tax on the entire amount invoiced to taxpayer's customers on the basis that the proceeds were received in a retail unitary transaction. Taxpayer protests the assessment on the delivery charges based upon taxpayer's contention that the charges for delivery services, in fact, were separated from the sale of the sand and stone.

An excise tax, known as the state gross retail tax (sales tax), is imposed on retail transactions made in Indiana. IC 6-2.5-2-1. A taxable retail transaction is "a transaction of a retail merchant that constitutes selling at retail as described in IC 6-2.5-4." IC 6-2.5-1-2(a). Selling at retail requires a transfer of tangible personal property. IC 6-2.5-4-1(b)(2). Since a service does not constitute tangible personal property, the sale of services usually fall outside the scope of the gross retail tax. However, there are two instances when an otherwise non-taxable sale of a service is subject to sales tax. The first is when the services are performed with respect to tangible personal property being transferred in a retail transaction and the services take place prior to the transfer of the tangible personal property. IC 6-2.5-4-1(e). The second is when the services are part of a retail unitary transaction. IC 6-2.5-1-2.

A unitary transaction is defined as a transaction that includes the transfer of tangible personal property and the provision of services for a single charge pursuant to a single agreement or order. IC 6-2.5-1-1. A retail unitary transaction is a unitary transaction that is also a retail transaction. Under IC 6-2.5-1-1, taxpayer's sale of sand and stone and delivery service does not constitute a retail unitary transaction. While the sale of the materials and the service are furnished under a single order, the additional documentation that taxpayer submitted at its protest hearing clearly establishes that taxpayer does not calculate a combined charge for the materials and services but charges them separately.

In the *Explanation of Adjustments*, the auditor states that sales tax was due on the entire amount invoiced to customers because taxpayer provided its customers with "lump-sum" invoices. However, case law does not lend support to the auditor's broad interpretation of the regulation. The legislature did not intend for non-taxable services to be subject to tax merely because performance occurred in a unitary transaction. *Cowden & Sons Trucking, Inc. v. Indiana Dept. of State Revenue*, 575 N.E.2d 718, 723 (Ind.Tax Ct. 1991). As the court in *Cowden* observed, "generally, services [are taxable] only when the transfer of property and the rendition of services in a retail unitary transaction are inextricable and indivisible . . ." *Cowden*, 575 N.E.2d at 722.

> Consequently, the divisibility of a transaction is indicated by the temporal relationship between the provision of the services and the transfer of the property, that is, services performed prior to a transfer of property indicate an inextricable transaction wholly subject to sales tax, IC 6-2.5-4-1(e)(2), and services performed after a transfer of property indicate a divisible transaction in which the sale is taxed but the services are not.

Id. In *Cowden*, the court found that the provision of hauling services was provided concurrently with the transfer of stone. After making this determination, the court applied a multi-factor test and found that the service and sale of property were not subject to sales tax because the transactions were not inextricable and indivisible. In reaching its finding, the court looked to Cowden's records, the overall nature of its business, and the nature of the unitary transactions. It is important to note that the court in *Cowden*, adopted the multi-factor test only after it had determined that the delivery of the goods at issue occurred not before or after but concurrently with the transfer of goods. *Id*. at 722. The multi-factor test will only be applied where the time of delivery of the service is inconclusive.

Applying the reasoning of *Cowden*, we now look to whether taxpayer's delivery services occurred before or after the transfer of the sand or stone from the taxpayer to its customers. If legal transfer occurs at the point of sale, then the delivery is non-taxable. If legal transfer does not occur until taxpayer actually delivers the sand or stone to the customer, then that service is taxable.

Indiana courts refer to the law of sales for interpreting tax laws that relate to the sale of goods. *Monarch Beverage v. Indiana Dept. of State Revenue*, 589 N.E.2d 1209, 1212 (Ind.Tax Ct. 1992). Under Indiana's Uniform Commercial Code:

> Unless otherwise explicitly agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods . . .
>
> (a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but
>
> (b) if the contract requires delivery at destination, title passes on tender there.

IC 26-1-2-401(2).

Subsection (a) above recognizes the situation where a buyer contracts to have the seller send purchased goods, but the buyer does not require the seller to deliver the goods to their destination. Under this scenario, the legislature determined that title passes when the goods have indeed been shipped. Subsection (b) illustrates the situation where a buyer contracts to have the seller send purchased goods and requires seller to deliver the goods to their destination. We find the facts of the instant case to be more closely aligned with the situation set forth in subsection (b) above.

Taxpayer is in the business of selling sand and stone. Sand and stone are heavy, bulky products that must be delivered by trucks equipped to handle excess weight. As such, the majority of taxpayer's customers purchase both sand and stone and delivery services, while a smaller percentage of customers receive only delivery services. When taxpayer

agrees to make a sale of sand or stone to its customers, the customers (in the instance where the sale is for both materials and services) contract for materials and delivery, plus any applicable sales tax due. Although taxpayer's final invoice printed and delivered to taxpayer's customers separately lists the material costs from the labor costs from the sales tax, we do not believe that the contract is completed until taxpayer delivers the materials to the customer's destination.

Here we find that legal transfer of the sand and stone sold occurs after taxpayer has delivered the materials to its customers' destinations. As such, taxpayer's delivery charges are taxable under IC 6-2.5-4-1(e) because such delivery is performed prior to legal transfer.

FINDING

Taxpayer's protest is respectfully denied.

III. State Gross Retail Tax—Manufacturing Exemption

DISCUSSION

Taxpayer protests the assessment of use tax upon 20% of taxpayer's use of its front-end loaders. Taxpayer's front-end loaders are used to transport the stone and sand from a crusher to a wash plant, to transport the stone and sand from the wash plant to a stockpile to allow moisture to drain and evaporate from the washed stone, and to load its trucks for delivery of the stone and sand to taxpayer's customers. Taxpayer asserts that the use of the loaders to load trucks for the delivery of stone and sand to taxpayer's customers is approximately 2% of the total loader usage. However, the auditor determined, after comparing loader usage of taxpayers operating similar businesses, that taxpayer's taxable use of the loaders was 20%.

There is no issue that the use of the loaders to feed the wash plant and to stockpile the stone and sand are exempt from sales tax, and the use of the loaders to load the stone and sand onto trucks for the delivery of the stone and sand to customers is taxable. *See* 45 IAC 2.2-5-9(g), Examples (1), (2) and (3). The issue before us is simply whether the auditor overestimated the taxable use of the loaders used to load stone and sand from the stockpiles onto taxpayer-owned trucks for delivery to taxpayer's customers.

IC 6-8.1-5-1 provides in pertinent part that:

> If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. . . . The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the

> proposed assessment is wrong rests with the person against whom the proposed assessment is made.

At the time of the audit, no information was available to the Department's auditor to determine the taxable usage of the front-end loaders. According to the auditor, taxpayer performed no studies to document the taxable percentage of use. *See Explanation of Adjustments*, pg. 8. The auditor, therefore, looked to taxable usage of front-end loaders used to load delivery trucks at other similarly operated businesses to determine taxpayer's taxable use. The auditor determined taxpayer's taxable use of its front-end loaders to be 20%.

Taxpayer protested the auditor's taxable use determination and assessment but did not offer any substantive evidence that the determination and assessment was invalid. As such, the taxpayer failed to meet the burden imposed by IC 6-8.1-5-1.

FINDING

Taxpayer's protest is denied.

IV. Tax Administration— Abatement of Penalty

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty.

IC 6-8.1-10-2.1(d) states that if a person subject to the negligence penalty imposed under said section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty. 45 IAC 15-11-2 defines negligence as the failure to use reasonable care, caution or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or Department regulations.

In order to waive the negligence penalty, taxpayer must prove that its failure to pay the full amount of tax due was due to reasonable cause. 45 IAC 15-11-2. Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ." 45 IAC 15-11-2(c). In determining whether reasonable cause existed, the Department may consider the nature of the tax involved, previous judicial precedents, previous department instructions, and previous audits. *Id*.

Here, taxpayer maintains that its failure to remit sales tax was due to personnel's lack of knowledge as to the sales tax due on retail unitary transactions, and what percentage of the use of taxpayer's loaders is subject to the Indiana sales tax. The Department determined that imposition of the negligence penalty was appropriate because taxpayer made no attempts to understand regulations governing sales tax due on retail unitary transactions, and failed to perform a formal study to determine actual taxable use of its manufacturing equipment.

In the instant case, we find that taxpayer has failed to demonstrate that, regarding the issues of unitary transactions and the manufacturing exemption, it exercised the degree of reasonable care required to justify waiving the ten percent negligence penalty. Taxpayer may not assert its own naivete as a basis for an abatement of penalty. 45 IAC 15-11-2(b) states that "[i]gnorance of the listed tax laws, rules and/or regulations is treated as negligence. Waiver of the penalty is inappropriate.

FINDING

Taxpayer’s protest is respectfully denied.

HLS/MR – 011708